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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 000509

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DEPT FOR EUR/RUS WARLICK, HOLMAN, AND GUHA
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DOC FOR 4231/IEP/EUR/JBROUGHER
NSC FOR GRAHAM AND MCKIBBEN

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TAGS: EPET ENRG ECON PREL RU
SUBJECT: RUSSIAN ENERGY: CHEVRON AND CPC - LOOKING AT OPTIONS

REF: 06 MOSCOW 12763

Classified By: Econ M/C Pamela Quanrud. Reasons 1.4 (b/d).

¶1. (C) Summary: On February 5, Chevron's Russia chief, Ian MacDonald, contacted us to talk about CPC expansion and the recently-inked Gazpromneft deal. (This discussion follows up on previous meetings with MacDonald with Mark Woloshyn, who Chevron has hired to shepherd along the Bosphorus bypass issue.) MacDonald expressed Chevron's frustration with Russia's delaying tactics on CPC and laid out a well-developed export option across the Caspian and beyond. Woloshyn added that Chevron had signed an MOU with the Kashagan operators to work together on this alternative. On the Burgas-Alexandropoulis (BAP) pipeline, Woloshyn complained that Bulgaria was still asking for too much and noted that the Russians are now looking at the possibility of re-opening talks with Turkey on the Samsun-Ceyhan bypass. MacDonald reported CPC had lost its latest appeal in its tax case, but minimized the impact to the consortium's bottom line if they were to lose on final appeal this spring. On a positive note, MacDonald hailed the recently inked joint venture with GazpromNeft as a foundation for the company to build on. Russia looks set to be left behind as its foot-dragging on CPC expansion leads Kazakh shippers to look for alternative export routes. End Summary.
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Frustrated on CPC...

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¶2. (C) While noting that CPC expansion is there for the taking if the GOR would demonstrate senior leadership, MacDonald said that he and other Chevron executives in the region were increasingly frustrated with Russia's foot-dragging. As an example of Russia's unwillingness to close, he recounted a conversation in which he was told that the Russians were thinking about adding yet another condition for CPC expansion -- because the GOR was concerned that the producing companies might actually agree to the latest demands. In spite of the time he has invested in the project, MacDonald left us with the impression that he was ready to throw in the towel on expansion and told us that the producing companies' "only options are to escalate matters or refuse to negotiate further."
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...But Still Need to Get Oil Out...

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¶3. (C) MacDonald said the frustration is company-wide and included their partners working on the giant Tengiz field in Kazakhstan. As such, MacDonald admitted that Chevron's announcement on a new southern route for Kazakhstan oil was a very real consideration of alternatives to Russia, and not just a negotiating tool to promote CPC. This route involves a pipeline from Atyrau to Kuryk, shipping oil across the Caspian to Baku, and a new pipeline from Baku to Supsa. MacDonald said that BP was not that keen on expanding BTC to accommodate these flows. Woloshyn says the oil may go in some combination of BTC, the Baku-Supsa line, and a new BTC (but not necessarily all). He had called on Transneft and informed them of this plan.

¶4. (C) Woloshyn said that Chevron signed an MOU with the Kashagan partners to work on this southern route and that this would involve what he claimed was "much more than 2 million b/d." Such a route would be perhaps the most complex transportation chain ever attempted anywhere and would involve a different consortium in each part of the transportation chain. He joked that it "might just be easier to work with Russia." Woloshyn continued that Kazakhstan wants to find routes out for its oil but doesn't want its fingerprints all over the search for alternatives because they fear upsetting the Russians. So, they are letting the companies take the lead on coming up with ideas.
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...And Still Need a Bypass

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¶5. (C) Chevron continues to be interested in BAP but both MacDonald and Woloshyn say the Bulgarians are still being obstinate. Woloshyn relays that the Bulgarians are insisting on ownership of the Burgas terminal and want to sell the

24.5% stake that they will get under the consortium up front for a currently ridiculous sum. Neither of these demands can or should be met. Transneft, he claims, has apparently gone to the Russian Ministry of Industry and Energy to suggest re-engaging with Turkey on the Samsun-Ceyhan bypass.
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Another Loss on Taxes

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¶6. (C) On the tax case (reftel), MacDonald said that CPC lost its appeal on December 25 and that it would go to the Court of Cassation next. He noted that losing the case would have a marginal financial cost -- about $10 million in NPV terms. It nonetheless continues to waste CPC's managerial time and a legal defeat "would be considered a breach of guarantees given by the Russian Federation in the Shareholders Agreement."
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Gazprom Neft Deal Could Be a Winner

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¶7. (C) MacDonald described the Chevron-Gazprom Neft deal as "quite promising" and said that this may lead to other deals with the company (Note: The JV was set up to carry out hydrocarbon exploration and production projects in the Yamal-Nenets region. Chevron currently holds a 70 percent stake in the JV but its share will fall to a minority holding as Gazprom Neft adds assets. End Note). In fact, MacDonald showed us a letter from Gazprom head Alexey Miller that mentioned potential joint projects in the Arctic. MacDonald described it as the best letter he has ever received from Gazprom.
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Comment

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¶8. (C) MacDonald believes the key problem for CPC expansion is lack of GOR leadership. Whether the Russian game is control of CPC itself (perhaps through deliberate neglect to close the deal in the hope of CPC's insolvency) or some other

grand bargain stretching from Greece to Kazakhstan may become an academic exercise if Kazakhstani producers head south for alternative routes. Another possible explanation is that Russia wants a comfort level that a Bosphorus bypass will happen before flooding the Black Sea with more foreign oil to compete with their own for transit through the Turkish Straits. One thing is certain -- whether it is Russia turning to Samsun-Ceyhan due to Bulgarian intransigence or Chevron turning to Supsa and BTC due to Russian intransigence, alternatives are plenty.
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